

# Fiscal Note

*Fiscal Services Division*



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**HF 2451** – Water, Metered Excise Tax (LSB6040HV.2)

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Fiscal Note Version – As amended and passed by the House

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## **Description**

**House File 2451**, as amended and passed by the House, exempts the sale of water by utilities from the sales tax and creates an excise tax on metered water that is deposited in the General Fund. These funds are then transferred incrementally to the Water Quality Financial Assistance Fund. One-sixth of the tax will be transferred from the General Fund beginning July 1, 2017 (FY 2018). This will increase by one-sixth each year until the full amount of the tax is transferred in FY 2023 and after. The tax is repealed after FY 2029 or when the state sales tax is increased, whichever is earlier.

**Water Quality Infrastructure Fund.** Appropriates a total of \$232.0 million (for the period FY 2017 through FY 2029) from the Rebuild Iowa Infrastructure (RIIF) Fund to the Water Quality Infrastructure Fund. The Division of Soil Conservation and Water Quality in the Department of Agriculture and Land Stewardship (DALs) will administer the Fund and can use up to 4.0% of the Fund for administration. The Fund is repealed on January 1, 2030. The Division is required to submit an annual report to the Governor and the General Assembly beginning October 1, 2017, detailing the expenditures of the previous year.

The Fund will support two types of projects as detailed in the [Iowa Nutrient Reduction Strategy](#):

- The Edge of Field Infrastructure Program supports projects that capture or filter nutrients that can enter surface water. These are long-term projects and examples include wetlands, bioreactor systems, saturated buffers, and land use changes.
- The In-Field Infrastructure Program supports projects to decrease erosion and surface water runoff. These are long-term projects and examples include terraces, waterways located on cropland, soil erosion control structures, and managed drainage systems.

**Water Quality Financial Assistance Fund.** Creates the Water Quality Financial Assistance Fund under the State Treasury and appropriates moneys from the Water Service Tax to the Fund. For FY 2018 through FY 2029, funds will be appropriated annually as follows:

- 40.0% to the Iowa Finance Authority (IFA) for the Wastewater and Drinking Water Financial Assistance Program. The IFA will administer the Program that consists of appropriations, interest, and other funds. The Program is expanded to include “drinking water” and source water protection projects. The IFA can use 1.0% of the funds for administration. The IFA is required to submit an annual report to the Governor and the General Assembly beginning October 1, 2018, detailing the expenditures of the previous year. The Program is amended to give priority to communities that employ technology to address the latest version of the Nutrient Reduction Strategy and eligibility is expanded to include utility management organizations and rural water systems.
- 45.0% to the IFA for the Water Quality Financing Program that funds projects to improve water quality related to surface water and groundwater. This is a loan program and the IFA will set the loan interest rates and charge fees to pay for the costs of processing loans.
- 15.0% to the Division of Soil Conservation and Water Quality in the DALs for the Water Quality Urban Infrastructure Program to fund demonstration projects that decrease erosion, storm water discharge, and other related projects. The projects will be funded on a cost-

share basis. The Division can use 4.0% of the funds for administration. Beginning July 1, 2018, funds can be used to support the three-year data collection of in-field practices at Iowa State University. Funds may also be used to develop and maintain a webpage displaying measurable indicators of change in state watersheds.

## **Background**

Currently, the sale of water by utilities to residential and nonresidential customers is subject to the sales tax, as well as any local option sales tax (LOST). Nonresidential sewage utilities are also subject to the sales tax, while residential sewage utilities are not. The state sales tax includes a portion that is directed to the Secure an Advanced Vision for Education (SAVE) Program, commonly referred to as the “sixth-cent.”

The Wastewater Treatment Financial Assistance Fund created in Iowa Code section [16.134](#) is for communities, with priority for disadvantaged communities, seeking to install or upgrade wastewater treatment facilities due to regulatory activity by the Department of Natural Resources. Grant awards are capped at \$500,000. The Fund received appropriations from the Rebuild Iowa Infrastructure Fund (RIIF) for the period of FY 2006 to FY 2008 for a total of \$11.0 million.

## **Assumptions**

- The annual sales tax attributable to metered water sales in FY 2015 is estimated by the Department of Revenue at \$20.3 million. This number was then increased by Moody’s projections of the Consumer Price Index (CPI) inflation index and population estimates from the REMI<sup>1</sup> forecast.
- Items or services exempt from the state sales tax are also exempt from any LOST. The bill does not provide for a local option sales tax on water services.
- The bill does not subject the new water service tax to the SAVE transfer.
- The section of the bill related to the tax becomes effective July 1, 2017 (FY 2018), and the tax is repealed July 1, 2029.

## **Fiscal Impact**

**Water Quality Infrastructure Fund.** The bill appropriates \$5.0 million from the RIIF to the Water Quality Infrastructure Fund in FY 2017 and specifies the appropriations for the period of FY 2018 through FY 2029.

**Water Quality Financial Assistance Fund.** The estimated flow of funds under current law and as proposed in [HF 2451](#) is shown in the following table. General Fund revenue and SAVE dollars will instead be diverted to the Water Quality Financial Assistance Fund. The LOST revenues will no longer be collected.

Flow of Funds - Current Law vs. Proposed HF 2451								
In Millions								
	CURRENT LAW				HF 2451			
	Est. Sales of Metered Water	5% Sales Tax to General Fund	Sales Tax to SAVE	LOST	Excise Tax @ 6% to General Fund less transfer to Asst Fund	Sales Tax to SAVE	LOST	Water Quality Financial Assistance Fund
FY 2018	\$ 371.4	\$ 18.6	\$ 3.7	\$ 3.1	\$ 18.6	\$ 0.0	\$ 0.0	\$ 3.7
FY 2019	384.6	19.2	3.8	3.2	15.4	0.0	0.0	7.6
FY 2020	396.7	19.8	4.0	3.3	11.9	0.0	0.0	11.9
FY 2021	408.4	20.4	4.1	3.4	8.2	0.0	0.0	16.4
FY 2022	420.2	21.0	4.2	3.5	4.2	0.0	0.0	21.0
FY 2023	432.2	21.6	4.3	3.6	0.0	0.0	0.0	25.9

<sup>1</sup> REMI refers to Regional Economic Models, Inc. See <http://www.remi.com/> for more information.

The estimated fiscal impact is shown below.

<b>Estimated Impact of HF 2451</b>				
In Millions				
	<b>General</b>			<b>Water Quality</b>
	<b>Fund</b>	<b>SAVE</b>	<b>LOST</b>	<b>Financial</b>
				<b>Assistance Fund</b>
FY 2018	\$ 0.0	\$ -3.7	\$ -3.1	\$ 3.7
FY 2019	-3.8	-3.8	-3.2	7.6
FY 2020	-7.9	-4.0	-3.3	11.9
FY 2021	-12.3	-4.1	-3.4	16.4
FY 2022	-16.8	-4.2	-3.5	21.0
FY 2023	-21.6	-4.3	-3.6	25.9

Once the full amount of the transfer is reached in FY 2023, revenues will grow approximately 2.9% per year until the program is repealed after FY 2029 or when the sales tax is increased.

From the Water Quality Financial Assistance Fund, funds will be appropriated as shown below.

<b>Appropriations from the Water Quality Financial Assistance Fund</b>			
	<b>Wastewater and</b>		<b>Water Quality</b>
	<b>Drinking Water</b>	<b>Water Quality</b>	<b>Urban</b>
	<b>Treatment Financial</b>	<b>Financing</b>	<b>Infrastructure</b>
	<b>Assistance Program</b>	<b>Program Fund</b>	<b>Program</b>
FY 2018	\$ 1,480,000	\$ 1,665,000	\$ 555,000
FY 2019	3,040,000	3,420,000	1,140,000
FY 2020	4,760,000	5,355,000	1,785,000
FY 2021	6,560,000	7,380,000	2,460,000
FY 2022	8,400,000	9,450,000	3,150,000
FY 2023	10,360,000	11,655,000	3,885,000

The costs of establishing a new excise tax at the Department of Revenue are estimated at \$1.0 million, due to the inadequacy of the existing fields in the Sales Tax Return System to capture the necessary data for the new tax. This includes the cost of establishing a new method for taxpayers to report the Water Service Tax that will include new fields, and will necessitate the need for changes in processing, tax calculations in audit systems, as well as return review and calculations in mainframe data systems.

If a water utility is located within a Flood Mitigation District, the sales tax remitted will be included in that area's initial increment calculation. By exempting the sale of water services from the sales and use tax, a mitigation district may be impacted by decreasing the taxable increment of sales and services.

### **Sources**

Iowa Department of Revenue  
LSA analysis and calculations

/s/ Holly M. Lyons

April 12, 2016

The fiscal note for this bill was prepared pursuant to [Joint Rule 17](#) and the Iowa Code. Data used in developing this fiscal note is available from the Fiscal Services Division of the LSA upon request.